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# Policy Ideas and Proposals to Reconcile Economic Growth and Welfare Development in South Korea

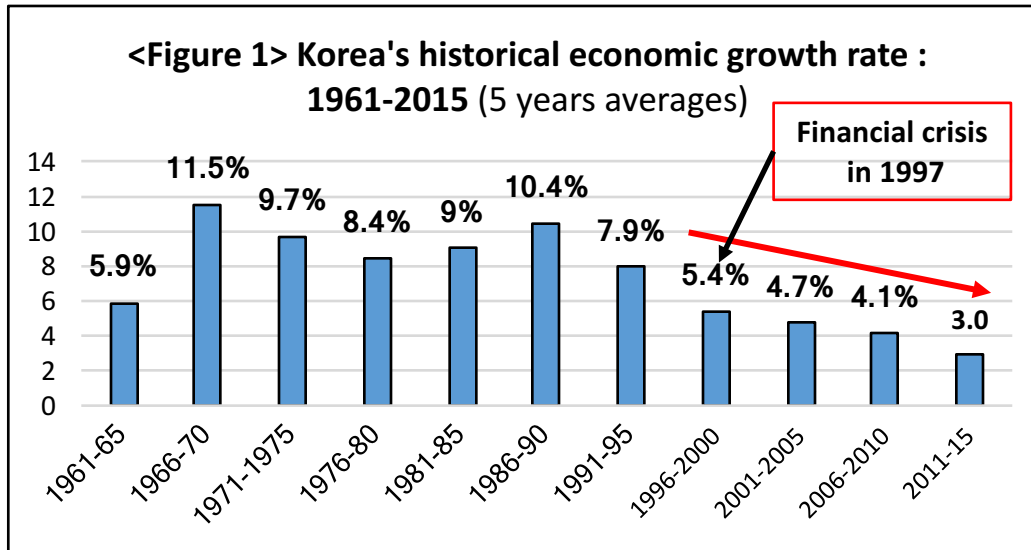
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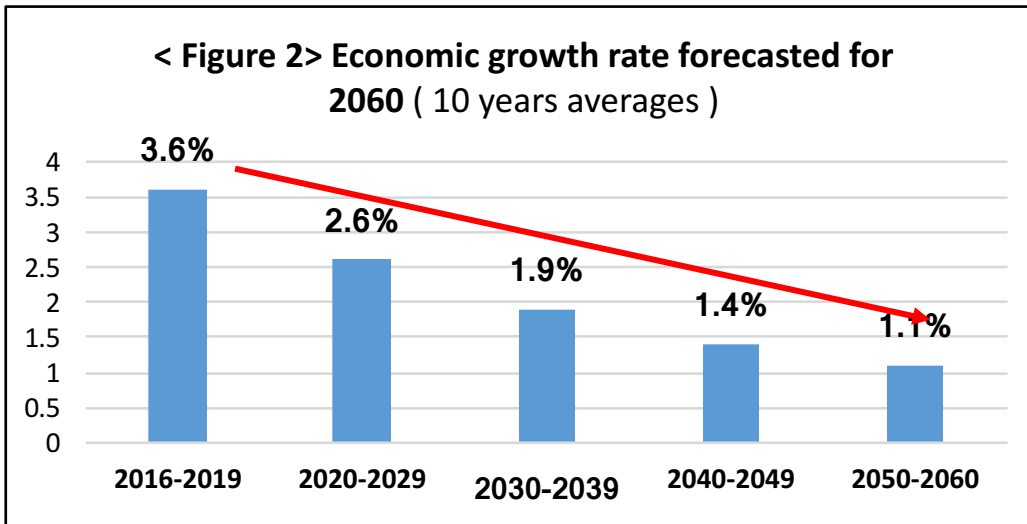
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- The period of high economic growth in South Korea ended after the financial crisis in 1997. Since then, the Korean economy entered a long-term low growth phase. In addition, Korea has been facing demographic challenges with low birth rates, ageing population and severe labor markets dualization.
- Around 2010, Korea has entered an early stage of the welfare state, spending only about 10% of GDP on social expenditures. Because of this extremely unfavorable socio-economic and demographic changes, the Korean welfare state is facing with fundamental challenges in moving toward a more comprehensive welfare state.
- The ‘mainstream’ in the Korean society continues to believe that an export-led growth path is still a viable option in a slow growth phase. Most importantly, they are still dominated by the perspective emphasizing the negative relationship between welfare and the economic growth.
- Recently, in Korea, there has been a number of claims saying that the conventional relationship between economic growth and the welfare development must be redefined. This new emerging paradigm shift, yet not dominantly strong enough in Korea at this stage, pays more attentions to the positive economic effects of welfare expenditures in boosting domestic demands under the low economic growth scenario.
- In the line with this new emerging paradigm, several ideas and policy proposals have been suggested by pro-welfare social forces and are currently being debated. They include ‘income-led growth’ strategy, social investment policies enhancing employability among youths and women, boosting domestic demand by expanding cash allowances, investing public pension fund in providing more public housing and welfare facilities, and creating more stable public jobs in social service sectors.

# Background : Ending of high-economic growth and entering into a low-growth phase



Source : KOSIS(2016)

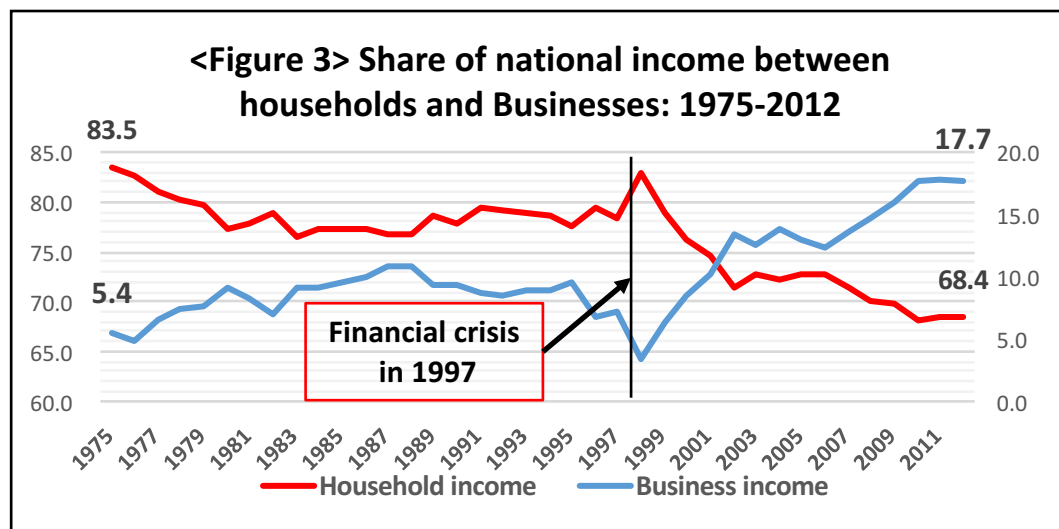


Source: Ministry of Strategy and Finance(2016)

- High economic growth from the 1960s to the mid 1990s due to export-led growth strategy.
- Economic growth led to income growth for escaping from absolute poverty (trickle-down effects).
- Gradual reduction of economic growth rate after the financial crisis in 1997.

- Entering into a long-term low economic growth phase, growth averaging just over 1-2% per annum in the long run.

# Background : No more trickle-down effects



Source : Bank of Korea (2015)

**<Table 1> Inequality-reduction effect of taxes and public transfers in selected OECD countries (2012)**

	Market income Gini (A)	Disposable income Gini (B)	Poverty reduction effect ((A-B)/A*100)
Korea	0.329	0.300	8.81
Sweden	0.43	0.23	46.51
France	0.48	0.28	41.67
Germany	0.51	0.3	41.18
Japan	0.44	0.32	27.27
US	0.48	0.38	20.83
OECD average	0.45	0.31	31.11

Source: OECD (<http://stats.oecd.org/index.aspx>)

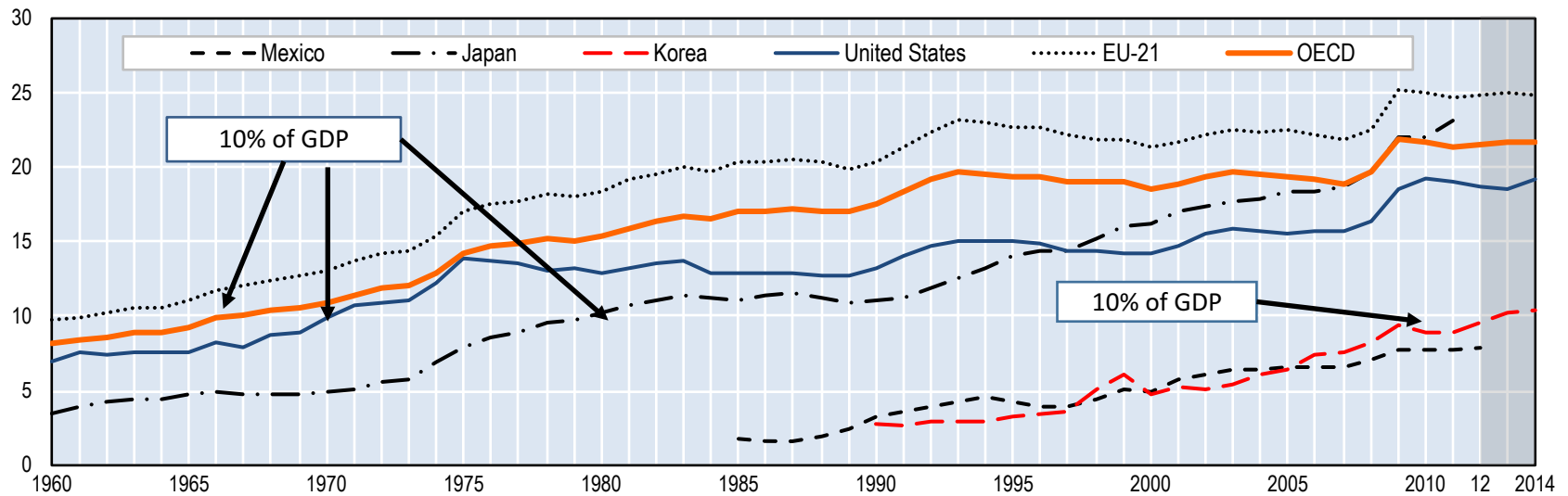
- Companies have taken much more of the fruits of Korea's economic growth than have households.
- Trend toward polarization between 'rich companies' and 'poor households'.
- Waning trickle-down effects of export industries.

- Widening income gaps between the rich and the poor.
- Weak inequality and poverty reduction effects of taxes and public transfers.

# Welfare State Building under the unfavorable socio-economic conditions

- Belated takeoff of the Korean welfare state in 1990s.
- Korea has entered into an early stage of the welfare state, spending 10% of GDP on social expenditures around 2010.
- However, along with low economic growth rate, Korea has faced with fundamental negative changes in demographics and labor markets in developing its welfare state.

<Figure 4> Public social expenditure as a percent of GDP in 1960-2014

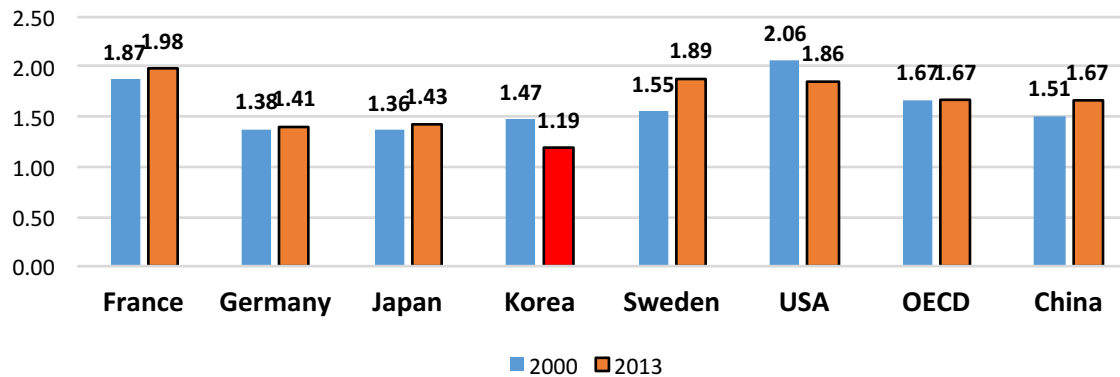


Source: OECD (2014a)

# Demographic context : Low birth rate and aging population

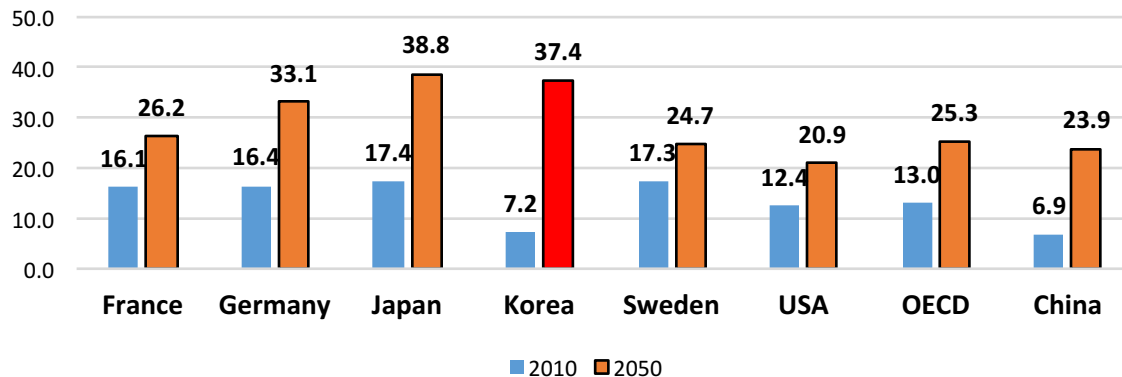
**<Figure 4> Total fertility rate in selected countries**

(Numbers of children born to women aged 15 to 49)



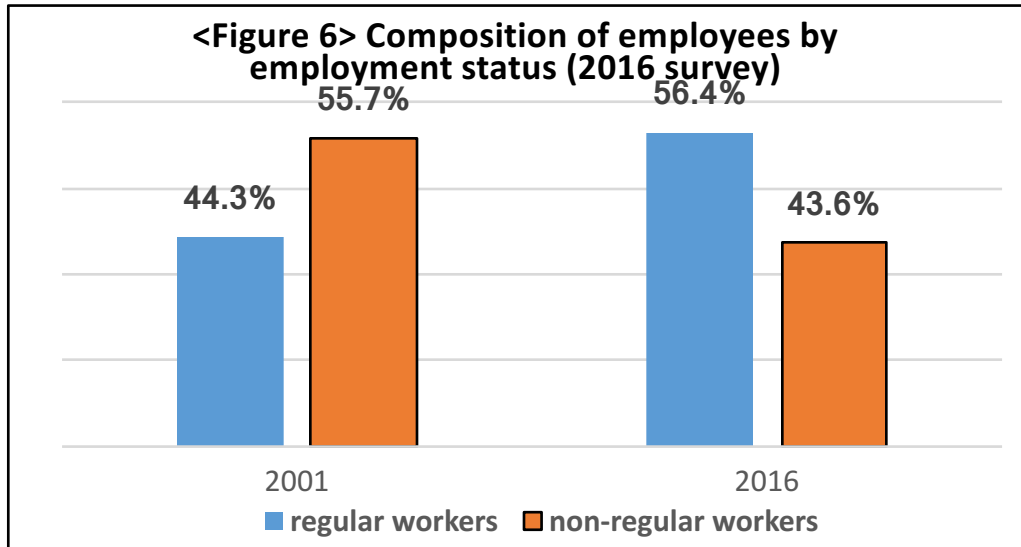
Source: OECD(2016:15)

**<Figure 5> Share of the elderly population (age 65+) in selected countries** (As a percentage of total population)

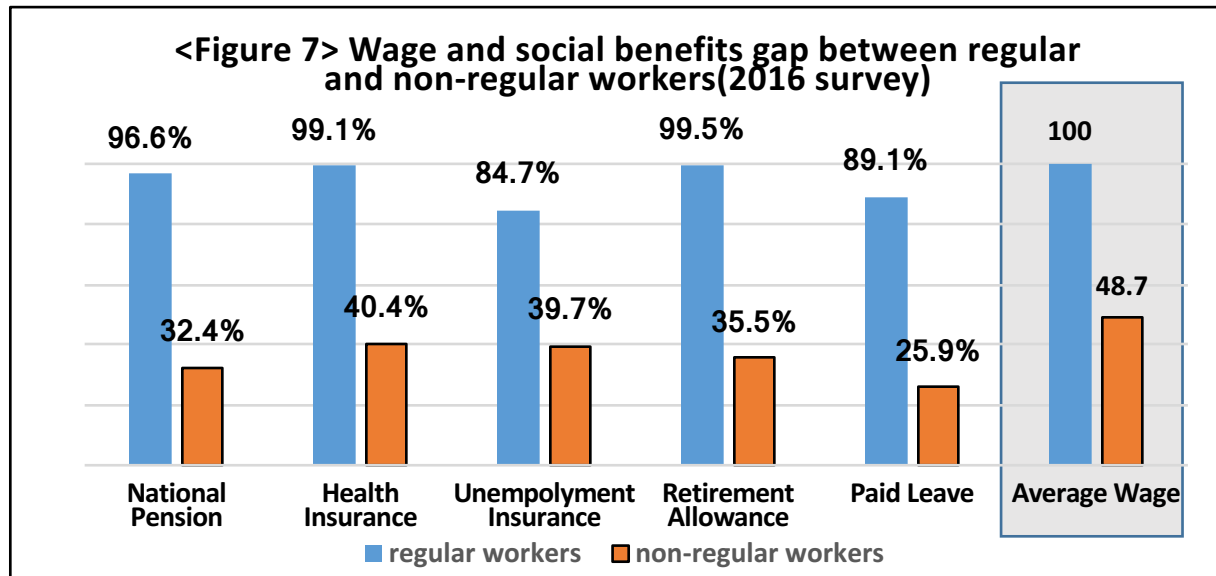


Source: OECD(2014b:19)

- Lowest fertility rate in the world.
- Rapid speed of population ageing.
- Less tax payers and more welfare recipients in the future.
- Fiscal strains in financing welfare programs.



- Highly fragmented labor markets by employment status.
- Gradually decreasing size of non-regular workers, but still highly dualized labor markets.

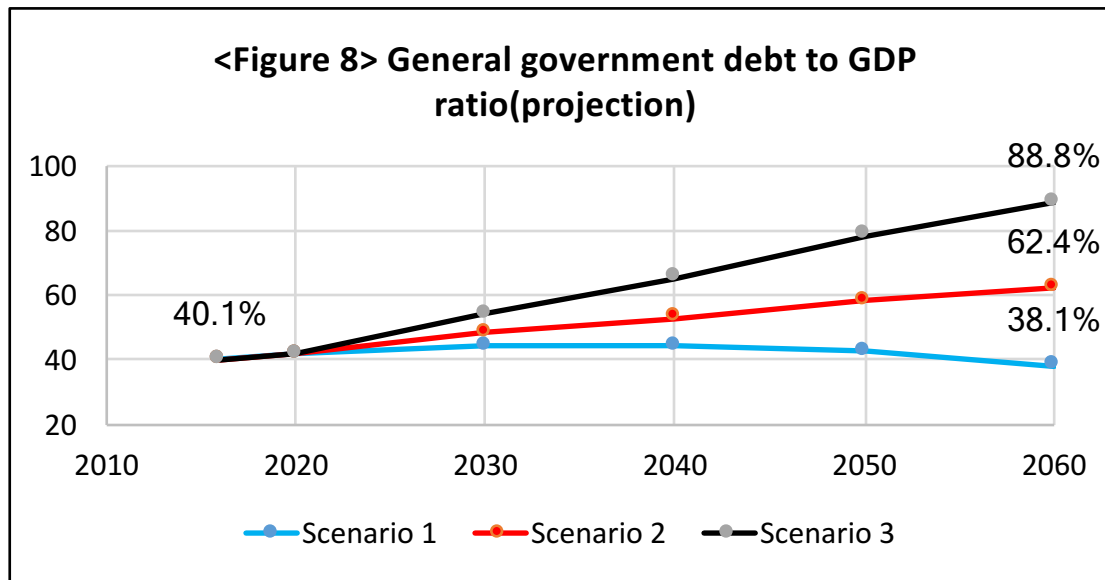


- Large gaps in wages and social benefits between regular and non-regular workers
- Great barrier in realizing universal coverage in social security and an universal welfare state

Source: Kim.Y.S(2016)

# Mainstream's strategy : Economic growth without welfare?

- 'Long-term Economic Outlook 2060' report by the Ministry of Strategy and Finance.
- Stronger fiscal discipline in the face of growing economic uncertainties and negative demographic changes.
- Keeping national debt to GDP ratio at 40% range in the foreseeable future.
- Maintaining current levels of tax burden.
- Tighter controls on welfare spending including even cutting social benefits.



- The mainstream is still seeking an 'economic growth **'without welfare'** which was dominant under the developmental era of Korea.
- Is that an viable option under the deepening socio-economic pressures?

Source: Ministry of Strategy and Finance(2016)

Note : Scenario 1: Cutting 10% of public expenditures from 2016

Scenario 2: No policy changes from 2016

Scenario 3 : Introducing new mandatory social programs in 2020



# New ideas and policy proposals(1): ‘Income-led growth’ strategy

- ‘Income-led growth’ strategy as an alternative for ‘profits-led growth(‘export-led growth.’)
- Boosting domestic consumption by increasing social benefits as well as labor’s income share.
  - Debates over ‘universal basic income’ plan: promoting household consumptions.
  - Expanding social benefits : proposals for creating universal child allowance, youth allowance (for labor market outsiders or entrants), and increasing the amount of basic pension for the elderly.

<Table 2> Trends of Final Demand Composition in Korea

Year	Private Consumption	Government Consumption	Investment	Exports
1990	41.0	7.7	28.9	22.5
1995	40.3	7.5	29.6	22.6
2000	42.0	7.3	22.4	28.2
2005	39.3	10.1	21.6	29.0
2010	35.0	10.1	19.7	35.1
2014	33.6	10.8	19.3	36.2
Japan(2005)	50.1	16.2	20.5	13.2

Source: Bank of Korea(2015)

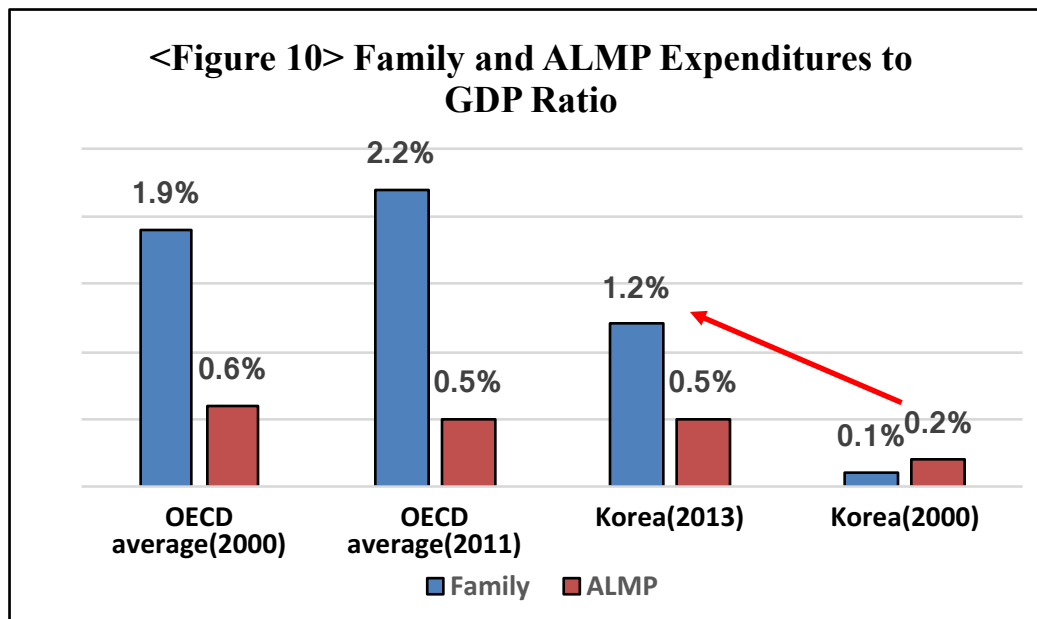
- Korea is one of the most open economy countries in the world.
- Open economy constantly confronts with industrial restructuring in order to survive in the highly competitive global markets.
- Industrial restructuring requires massive relocation of workers in the labor market. Therefore, without well-established social protection and job training system, relocation of workers would not be practical.
- Social protection system is one of the main bases supporting an open economy.



OECD(2016)

## New ideas and policy proposals(3): Social investment policy

- Social investment policies: enhancing employability of labor market outsiders through increasing the quality of job skills and providing favorable social environment for labor market participations.
- ALMP and ECEC(Early Childhood Education and Care) policies are main areas of the social investment policy.
- Great advancement in ALMP and ECEC polices in Korea over last decade, but there are some controversies over their policy outcomes.



OECD(2016) Social Expenditure Database

# New ideas and policy proposals(4): Investing pension reserves in public rental housing and public welfare facilities

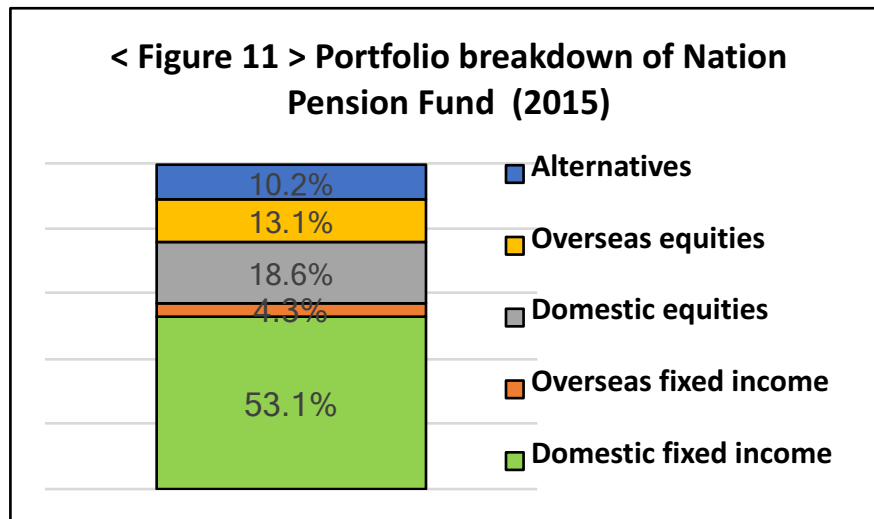
<Table 3> 5 Largest Public Pension Reserves Fund

	USD bn.	% of GDP(Rank)
<b>Korea(NPS)</b>	<b>404.5</b>	<b>32.4(1)</b>
<b>Sweden(Aps)</b>	<b>164.7</b>	<b>29.0(2)</b>
<b>Japan(GPIF)</b>	<b>1223.9</b>	<b>26.9(3)</b>
<b>USA(Trust Fund)</b>	<b>2764.4</b>	<b>16.5(4)</b>
<b>Canada(CPP)</b>	<b>189.3</b>	<b>10.7(5)</b>

OECD(2014c)

- Korea's NPS reserves is the largest one in terms of its GDP ratio.
- Most reserves are invested in domestic and overseas bonds and equities.
- Most portion in domestic equities investment are concentrated on big companies(conglomerates).

< Figure 11 > Portfolio breakdown of Nation Pension Fund (2015)

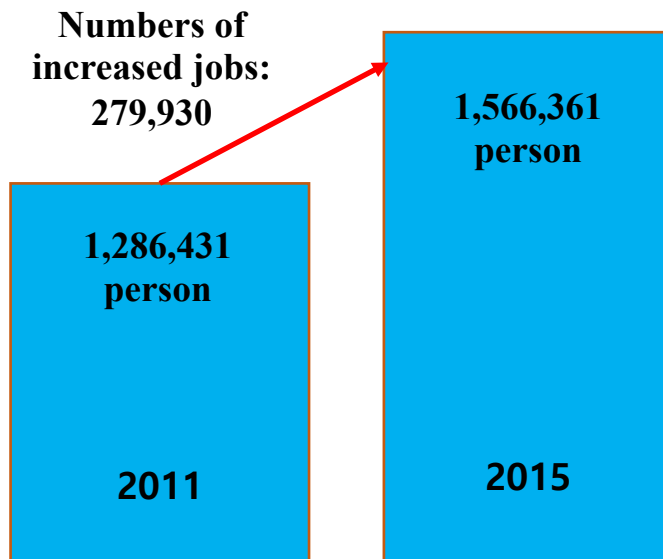


National Pension Service(2015)

- Investing 20% of newly accumulated reserves per year (total 100 trillion Won for 10 years) in building public rental housing, public healthcare and care facilities for child and the elderly.
- Goals of the proposal : removing the barriers of marriage and childrearing by reducing rent costs and care fees; reconciling work and home life for women; raising low birth rate; boosting construction industries. etc.

# New ideas and policy proposals(5): Increasing public welfare facilities and public sector jobs by establishing ‘social service corporation’

**<Figure 12> Numbers of employment in health and social service sectors (2011-2015)**



Source: Ministry of Health and Welfare(2015)

- Sizable numbers of new jobs are created in health and social care sectors under the jobless growth of Korea.
- Care workers mostly employed in small and private care facilities suffering from low wage and inferior working conditions.
- Proposal to establish ‘social service corporation(社会service公團)’ that not only directly operates care facilities, but hires care workers directly.
- Aiming to increase publicly funded and operated care facilities and quality jobs in the public sectors.
- Plan to launch a social service corporation in Seoul City in 2017.

- Because of the dramatic economic growth experience in Korea, the main stream policy ideas tend to think that expanding welfare provision hampers achieving economic growth.
- A growing body of literatures(OECD,2015; Dabla-Norris et.al,2015), however, suggests that higher inequality in income and wealth may give negative impacts on sustainable economic growth.
- Korea is in a very challenging transition period. Under the very negative economic, demographic, and labor market conditions, the country has to move towards a more universal welfare state
- Some groups are proposing new ideas and policy proposals which support that expanding welfare provision does not contrast with any economic growth.
- Although these ideas are still ongoing and have not become main stream policy ideas, there are great potentials in those ideas and it will appear as significant values when existing economic growth strategy reveals their limitations.

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